1960 WINTER ISSUE

the Illinois CPA

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the Illinois CPA

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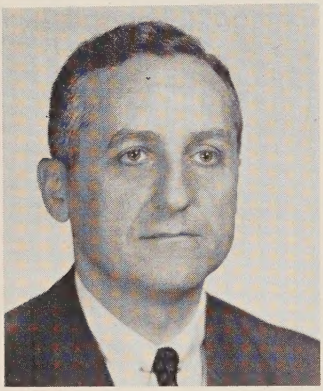


President's PAGE

At the October 1960 meeting of the American Institute of CPAs held in Philadelphia, the Institute's Ethics Committee proposed a revision of the AICPA rule on independence. This revision would bring the rule into closer conformance with the Illinois Society's Rule 13 adopted in 1952 and made effective as of June 1, 1954.

To refresh your memory, the Institute's present rule provides, briefly, that a member shall not express an opinion on a publicly held enterprise if he owns a financial interest in it which is substantial in relation to its capital or to his personal fortune. A similar restriction is imposed with respect to opinions on financial statements used for credit purposes unless in his report the member discloses such interest. The Illinois Society's rule prohibits the expression of an opinion by a member on the financial statements of any organization in which he has **any** financial interest or with which he is connected as a member of its official family.

Vocal opposition of certain members present at the Institute's meeting in Philadelphia resulted in deferment of a vote as to whether the proposed amendment should be submitted to the membership at large for a mail ballot. The arguments against the proposed revision were woefully shortsighted.

One argument asserted that the proposed effective date of the revision, January 1, 1962, would not allow sufficient time for the members to accommodate themselves to the

change. You be the judge of that one.

Another argument was that the change would work a hardship on smaller practitioners. In essence, the proponents of this view say they fear the revision will hit them in the pocketbook. This is a blatantly unprofessional stance that gives no house to the public interest involved. I may add that on the basis of our experience in Illinois this fear seems to be unwarranted.

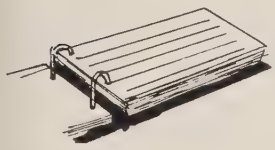
The third argument I find impossible to digest. The third group assumes a posture of deep hurt. These opposers say any rule which implies that a CPA may be deemed to lack independence because he owns a few paltry shares in a corporation to be examined by him is a monstrous assault upon his honor and dignity which he should not countenance.

I only hope that the hardheaded public does not suddenly recall what Samuel Johnson once said: "The louder a man proclaims his honesty, the faster I count my silverware."

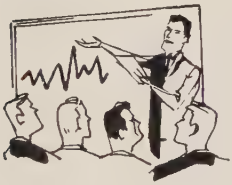
The unique characteristic which sets the CPA apart from members of other professions is his status of independence, particularly in the area of expressing opinions on financial statements. It is in this status that the CPA is of greatest service to the public. Whatever is done to preserve and promote that status serves to increase the public's confidence in the profession. Any erosion of that status, or any failure to foster it, will have a disastrous opposite effect.

It seems like the Institute has some educating to do before its 1961 annual meeting to be held in Chicago.

FINANCIAL REPORTS



INVENTORY ANALYSIS



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A Realistic and Reasonable Approach to Meeting Reporting Requirements Under the Act

Reporting Under the Welfare and Pension Plan Disclosure Act

by R. E. Larsen

During the past two decades private employe welfare and pension plans have experienced phenomenal growth. In labor negotiations, such plans have become as important as, and sometimes more important than, actual wage increases. At January 1, 1959, it was estimated that nearly 10 billion dollars per year was currently being contributed to such plans, and reserves for pension plans alone totaled approximately 30 billion dollars. There can be little doubt that these figures have increased in the past year and will continue to increase.

The facts uncovered by the McClellan committee during its investigations of labor and management practices undoubtedly helped to spur Congress into action. While it was apparent that the great majority of plans were being responsibly and honestly administered, there were some instances of abuse and mismanagement due to incompetence and negligence. The sentiment of Congress is displayed in this quotation from the Act:

> "Inasmuch as the continued well-being and security of millions of employes and their dependents are affected by these plans and in order to protect interstate commerce and the interest of participants in employe welfare and pension benefit plans and their beneficiaries, a disclosure and annual reporting of financial and other information to participants and their beneficiaries must now be made."

In its report to the House of Representatives, the House Labor Committee stated the belief that the approximately 85 million employe-beneficiaries, who depend to an important degree upon welfare and pension plans for their economic security in the event of retirement, disability, or death are entitled to a regular accounting of the financial operations and assets of these plans by those who manage them. On the other hand, it stated, legislation which would hamper or burden the legitimate management of such plans or impose burdensome administrative costs, and thereby dissipate the monies which would otherwise be available to pay benefits to the beneficiaries of such plans, should be avoided.

It was in this atmosphere that the Congress passed the Welfare and Pension Plan Disclosure Act on August 19, 1958. The effective date of the Act was January 1, 1959. Space does not permit a complete

review of the provisions of the Act, but I would like to refresh your memories on some of the more basic provisions.

Basic Provisions of the Act

Plans of employers who are engaged in commerce or in any industry or activity affecting commerce, and plans of employe organizations which represent employes engaged in commerce, or in an activity affecting commerce, are included within the coverage of the Act unless they cover twenty-five employes or less. Other plans which are specifically excluded are those administered by the Federal government or by the government of a State, or by any political subdivision thereof. Also excluded are plans established and maintained for the purpose of complying with Workmen's Compensation laws. The final exclusions are for those plans which are administered as a corollary to membership in a fraternal organization, and plans of charitable organizations exempt from taxation under the Internal Revenue Code of 1954.

The definitions of an "employe welfare benefit plan" and an "employe pension benefit plan" restrict the application of the Act to plans which provide medical, surgical, hospital care or benefits; or benefits in case of sickness, accident, disability, death, or unemployment; or retirement benefits.

The administrator of each plan is required to make available for examination in the principal office of the plan, copies of a description of the plan and the latest annual report of the plan. Upon written request, he is required to deliver to a participant or beneficiary a copy of the description and a summary of the latest annual report by mailing them to the last known address of the individual. He is also required to file two copies of each plan description and annual report with the Secretary of Labor.

The Department of Labor was given authority to promulgate forms to assist plan administrators in filing the required information. The Department of Labor was not given the authority to require reporting on forms it designed around its interpretation of the law. Congress refused to grant requested investigative and enforcement powers to the Department of Labor, but instead made the law self-policing. This was done intentionally in order to grant the greatest possible latitude to comply at the lowest possible administrative cost consistent with the intent and spirit of the law and with the various complexities of the many plans which would be reported. Many administrators, however, failed to exercise their rights and, instead, requested the Department of Labor to interpret, explain, and expand on various provisions of the law. As a result, although purposely denied this authority by Congress, the Department of Labor issued some opinions and directives concerning filing requirements many of which requested data not specifically required under the law. A real danger exists if this practice is continued. These opinions and directives will tend to establish requirements which will severely hamper those administrators who are now properly exercising their rights to interpret the provisions of the law consistent with legislative intent, and eventually additional funds will have to be channeled to the Department of Labor to cover the cost of this unnecessary service.

It is becoming increasingly rare or Congress to give due recognition o the burden of heavy administrative ost imposed upon business in conection with this type of legislation. When such recognition is given, we n business cannot afford to ignore t and revert to the easy, but very xpensive practice, of letting the varius departments of government do our hinking for us. If we do not make se of the self-determining powers ranted us in connection with this aw, consideration of this same type f provision in future legislation may e lost forever.

Compliance with Requirements

Each plan administrator should use he following guideposts in complying ith the reporting requirements under he law:

1. He should consider that he has an obligation to make full use of the self-interpreting powers granted by Congress, and he should guard this prerogative carefully.
2. He should keep abreast of the information being published on the Act by various employer organizations, insurance carriers and many other organizations, because such data can prove useful in acquiring and maintaining a good understanding of reporting and disclosure requirements.
3. He should interpret the law as it applies to his own particular plans and should comply at the lowest possible administrative cost consistent with the intent and spirit of the law.

With respect to the first item, we hould be ever mindful of the pres-ures being brought to bear on Con-ress to pass additional legislation esulting in stronger governmental controls over reporting requirements. A constant vigil should be maintained, and we should express our beliefs that the present law is adequate and that it should not be expanded further.

I have previously outlined the three basic requirements of the law in connection with the disclosure and reporting function. While it was relatively easy to decide what had to be done with respect to the general requirements of the Act, decisions regarding what plans were covered, who was the administrator of each plan, the type, nature and amount of information to be divulged, and the establishment of procedures to provide the required information were not quite so easy.

The first step was to decide the extent to which the Act applied in each particular case. A careful analysis of the provisions of the law defining pension and welfare plans showed that a reporting was required only in connection with those plans which were communicated to or had their benefits described in writing to the employes. Various management organizations, insurance companies, and other organizations were extremely helpful to employers in this regard. These organizations, through their publications, carefully analyzed this portion of the law and were almost unanimous in their opinion that so-called plans representing informal promises and certain "fringe" items were not covered by the law. This pertained to items such as vacation pay, cost-of-living allowances, athletic and recreational facilities, discount sales to employes, and the occasional pay-

RUSSELL E. LARSEN, CPA, is controller of American Steel Foundries. This article is adapted from a paper presented by Mr. Larsen at the annual meeting of the Illinois Society of Certified Public Accountants held in Chicago in June 1960.

ment of salary to an employe during a period of absence from work. There were, of course, a number of other so-called plans which fell into a grey area wherein the employer was required to exercise his prerogative of self-interpretation concerning coverage under the law.

One Company's Experience

Before discussiong our experiences at American Steel Foundries, it might be well to give you a few facts about our size and scope of operations. We have 7,200 employes and 23 plants in the United States and two in Canada. We decided that the Act applied only to those plans of ours which were reduced to writing, which covered twenty-six or more employes, and which had been formally communicated to the entire group of employes covered.

The next problem to be faced was the determination of who was the administrator of each plan. The law is not too explicit in this area. Insurance carriers and most outsiders who may have been designated as trustees in connection with pure employer sponsored or financed plans were, for the most part, quick to disavow any responsibility with respect to the reporting requirements of the law. We concluded that the company (American Steel Foundries) was the administrator of each of our plans. I believe that a careful analysis of the House Labor Committee's Report supports the conclusion that, with a few specific exceptions, Congress generally intended that the responsibility was to be placed upon the employer or an agent designated by the employer.

There are two separate and distinct phases of the law. The first requires a report describing the existence, type and benefit provisions of each particular plan, and the second requires an annual reporting of the financial operations and assets of each plan.

In connection with the filing of a description of the plan, the Act, while using very general terms, specifically lists certain types of information which must be disclosed. However, the Act leaves the amount of detail which must be submitted to the discretion of the plan administrator. The basic questions facing the administrators were generally the form in which the information would be presented and the amount of detail to be submitted in connection with certain pertinent information. The Department of Labor provided assistance in connection with the first question through the release of Form D-1 which could be used in submitting a description of each plan. While answers to some of the questions appearing on this form were not required by the Act, in my opinion, the form provided a useful tool for disclosure purposes. Possibly the largest single criticism which could be directed at the Department of Labor was that the form instructions failed to mention that the use of the form was voluntary. This omission created the impression that its use was mandatory. In my opinion it should have been pointed out that its use was optional and that it was permissible to use all or any part of the material in any manner of reporting selected by the administrator within the requirements of the law.

Possibly the most important item for consideration in connection with the use of Form D-1 was the answer to Question 12 which asked for copies of the plan or bargaining agreement, trust agreement, contract, or other instrument under which the plan was

established and is operated; the schedule of plan benefits; and the procedures to be followed under the plan in presenting claims for benefits and for appealing denial of claims. It was apparent that there was no single rule which could be followed by all administrators in handling these three items. The House Labor Committee Report offered a useful rule of practical interpretation in this area. The report said and I quote: "The contract establishing, defining or redefining the plan itself would have to be furnished, but an adequate summary should suffice in regard to the bulky, and at times extremely cumbersome documents, which often are found in connection particularly with larger plans, such as insurance contract, procedure manuals and similar documents." This would seem to indicate that the Congress did not intend to set up extremely rigid disclosure requirements in connection with plan descriptions, but again left the door open for plan administrators to exercise their judgment to substitute other documents or brief summaries to replace lengthy and formal descriptive material.

We concluded that we would make the disclosure of our plans at the lowest administrative costs possible and that we would supply only that data specifically required by law. For example, in connection with items (a) and (b) of Question 12 on Form D-1, we used employe announcement booklets, despite the fact that such material has previously been made available to each employe as he became covered by one of our plans. In some cases for plans where such booklets were unavailable, we substituted a sample copy of the group insurance certificate which also had been previously supplied each employe, and in connection with certain funded plans, we used copies of the trust agreements showing the terms and conditions under which the trust was established and is operated. Item (c) of Question 12 on Form D-1 which calls for procedures to be followed in presenting claims for benefits and for appealing denial of claims was answered by means of a short summary statement with respect to the presentation of claims and the appeal procedure in connection with the denial of benefits.

Reporting of Amendments

Since the original filing of our plan descriptions we have been continually faced with the problem presented by the requirement in Section 6(b) of the Act which states that amendments to the plan reflecting changes in the data and information included in the original plan must be filed. The problem is one of timing and determining what constitutes an "amendment" to the plan. This has been a real problem due to the continual changes that occur in procedures, administration, and benefit provisions of a number of our plans. Because the Act does not state when amendments to a plan should be filed, we have adopted a policy of reviewing each plan description and related information semiannually and making any required changes at that time. This procedure eliminates the need for a continuing review of these plans and, in our opinion, complies with the spirit of the law.

The question of what changes necessitate an amended filing has not been so easily handled. To illustrate this point consider, for example, supplemental unemployment benefit plans which came into existence in recent years in the steel industry. Soon after

these agreements were signed, basic differences in interpretations arose between labor and management in connection with the lengthy and complex provisions of the plans dealing with qualifications, funding, benefits, and many other items. This whole area was further complicated by the fact that certain states initially refused to permit supplementation to state unemployment compensation. This necessitated additional supplemental agreements to the original contracts to satisfy the objections raised by these states and to permit the payment of such benefits. In addition, these plans are coordinated with the state administered plans in such a manner that many of the frequent changes in state laws and regulations governing unemployment compensation benefits necessitate changes in the administration of private supplemental unemployment benefit plans. It became apparent that it was not practical to keep the reporting of these types of plans completely current. We, therefore, adopted the policy of submitting only those major amendments to the plans which were formally agreed to in writing by the parties, and we disregarded oral agreements which merely represented minor changes to clarify portions of the original provisions of the plans.

We have followed this same thinking with respect to our other types of pension and welfare plans in that we report only those amendments which materially affect or change the information contained in the documents that were filed with our initial plan descriptions.

Determination of Accounting Year

I might mention one other problem we encountered in connection with the disclosure filing. This was the determination of an accounting year for each plan. This was particularly important with respect to insured plans where it was necessary to coordinate the reporting year with the policy year so as to enable the carriers to prepare and submit to us the required data in connection with the annual reporting of the financial operations of the plan. There were, of course, some types of plans wherein this coordination could not be accomplished, such as the Blue Cross-Blue Shield Plans where separate experience records covering each specific group were not available. However, in these instances financial information with respect to the most recent fiscal year of the carrier was deemed suitable for use, regardless of the fact that such information did not correspond to the specific plan year being reported. Other plans which were funded through the medium of a trust presented no problem due to the fact almost all had been granted exempt status for federal income tax purposes and the data gathered annually for the federal information reports now serve this purpose.

Annual Reports

The above discussion briefly covers some of the more important problems which arose in connection with the filing of descriptive disclosure information. Now for a brief look at the preparation of annual reports for each plan. Section 7 of the law requires that an annual report shall be published within 120 days after the end of each plan year. As stated earlier, to fulfill the publication requirement of Section 8 of the law the administrator is required to do the following:

1. Make copies of the description of the

plan and of the latest annual report available for examination by any participant or beneficiary in the principal office of the plan.

2. Deliver upon written request to any participant or beneficiary, a copy of the description of the plan and a "summary" of the latest annual report, by mailing such documents to the last known address of the person making the request.
3. File with the Secretary of Labor two copies of the description of the plan and each annual report thereon.

These requirements made it necessary for each administrator to seek the answers to three questions; (1) when was the first annual report due, (2) was the necessary data readily available, and (3) what constituted a "summary" of an annual report?

We concluded that the first annual report for each plan would be required within 120 days from the end of the first plan year ending on or after January 1, 1959, the effective date of the Act. In other words, if a particular plan was on a calendar year basis, the first annual report was due no later than April 29, 1960.

In order to answer the second question concerning the availability of the information required for an annual reporting, it was necessary to take a good look at the adequacy of the records being kept with respect to the operation of each plan. Again I will describe our own approach to this matter and discuss the steps which we took to ensure the availability of the reporting data. Using the Form D-2 promulgated by the Department of Labor as a guide, we compared what we had with what we needed and then went to work.

Our plans were generally divided into two classes; those which were funded through the medium of a trust and those funded through the medium of an insurance carrier. It has been our experience that the insurance companies did an outstanding job in providing necessary data. In most instances we were informed that the statistical and financial data required for completion of the annual reports would be forwarded automatically as soon as they were available each year. To assist in this matter, employers were requested to make certain that all premium and supporting statements for the last months of each policy year were submitted as promptly as possible. As a result of this cooperation, we have experienced no difficulties or problems in the filing of annual reports for these plans.

Our experience was much the same with regard to those plans funded through the medium of trusts. In each instance we found that the information supplied by the trustees in connection with the filing of information returns for Federal income tax purposes for these plans was the same information needed for our reporting purposes. Other statistical information specifically required by the law was for the most part easily obtainable from our actuaries.

A great deal of thought was given to the third question regarding just what constitutes a summary of an annual report and the extent of the detail to be included in such a summary. We have consulted with our industrial relations people and have reviewed many of the publications available on this subject by various interested groups and organizations. Suggestions regarding the presentation of this information have been many and varied. They have ranged all the way from multi-colored formal reports resembling a corporation annual report to stockholders, to a brief two or three paragraph statement

which, for the most part, merely listed the receipts and disbursements and total numbers of employes covered during the reporting period. It is not possible to adopt a single summary form for all plans. Each must be tailor-made to fit the type of plan. We have sought to make our summaries brief and concise, keeping in mind that the readers are not actuaries or accountants, and that the purpose of the summary is to give the reader the necessary facts in a readily understandable form. You might be interested to learn that although seventeen months have passed since this law became effective and almost fourteen months have now elapsed since the filing of our disclosure information, and we have filed 31 annual reports, we have not received one single request from a participant or beneficiary for any information.

Responsibilities Must Be Met

This discussion has been an attempt merely to highlight some of the more important problems which we became aware of and faced in connection with the Act. Many other problems, equally worthy of discussion, have been faced by you and by others; however, space does not permit an elaborate and comprehensive discussion of all of them.

It is my understanding that the certified public accounting firms have performed valuable services in assisting and advising clients in all phases of reporting under the Welfare and Pension Plans Disclosure Act. I have read with concern the published reports of the unexpectedly small number of plan descriptions and annual reports which have been filed with the Secretary of Labor. We should urge all employers and administrators to assume the responsibilities and obligations placed on them by the Act. I am fearful that failure to do so will most surely result in legislation to extend and expand the scope of the present Act and to limit the present self-interpreting rights presently granted to administrators. We might even see greater governmental control over the very operation and administration of the plans themselves if business does not comply with the Act as presently written.

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—DieKay

A Summary of the Illinois Securities Law and of the Role of the CPA in Its Operation

The CPA and the Illinois Securities Law

By Donald L. Calvin

The certified public accountant has a momentous role in securities regulation under The Illinois Securities Law of 1953, as financial statements certified by an independent public accountant are required in connection with every application to register securities and as a part of every dealer's investment adviser's registration.

The purpose of this paper is briefly to outline the requirements of The Illinois Securities Law and the General Rules and Regulations promulgated thereunder regarding the registration of securities as they relate to the Certified Public Accountant.[1]

In view of the fact that The Illinois Securities Law of 1953 is not a disclosure type of "Blue Sky Law", but rather is a regulatory type of securities law, the work of the certified public accountant in connection with the application for registration of securities is extremely important. Not only must there be adequate disclosure in the financial statements, but the financial statements must also be sufficiently detailed to enable the staff of the Securities Division of the Office of the Secretary of State to examine the application for registration to determine whether the offering meets the requirements of The Illinois Securities Law of 1953 and the General Rules and Regulations thereunder.

Under the Illinois Securities Law, not only must all material facts concerning the issuer and the offering be disclosed, but applications for the registration of securities may be denied if the Secretary of State finds that the offering is inequitable or one which would work or tend to work a fraud or deceit on the purchasers thereof. The Securities Law contains substantive requirements whereby the Secretary of State may, for example, require an escrow of the proceeds of the offering or an escrow of securities which have been issued for intangible assets. The Secretary of State, under certain conditions outlined in the rules, may require the preparation of an independent appraisal of the physical assets of an issuer.

Background of the Law

The Illinois Securities Law, which became effective on January 1, 1954, is a comprehensive regulatory statute, administered by the Secretary of State, which regulates the sale of se-

[1] Pamphlet copies of The Illinois Securities Law of 1953 and The General Rules and Regulations are available on request from Charles F. Carpentier, Secretary of State, Securities Division, Springfield, Illinois.

curities in the State and requires the registration of securities dealers, salesmen and investment advisers.[2]

The Law requires that all securities offered or sold in Illinois must be registered with the Secretary of State unless the securities are exempt or unless sold in transactions which are exempt from the registration requirements of the Law.

Securities which are exempt from the registration requirements include securities, the inherent qualities of which eliminate the need for their registration, such as U. S. Government Bonds, or securities, the issuance of which is regulated by other regulatory authorities, for example, bank stock. Such securities are classed as "exempt securities" in the Law.

Transactions involving securities, the nature of which eliminates the need for registration of the securities being sold, are known as "exempt transactions" under the Law and include, for example, transactions involving the offering of securities to a bank, insurance company or other institutional investor or transactions involving the sale of securities to not more than fifteen persons in any period of twelve consecutive months.

Registration of Securities

If an exemption is not available for the securities or the transaction, the offering must be registered with the Secretary of State under the appropriate section of The Illinois Securities Law. In every registration, financial statements prepared and certified by an independent certified public accountant are required to be submitted as a part of the application for registration.

Registration of Investment Fund Shares and Face-Amount Certificate Contracts is accomplished under separate sections of the Law while all other securities are registered under Section 5. In view of the fact that all investment funds and face-amount certificate contract issuers registered in Illinois are also registered under the Federal Law, and for the further reason that only three face-amount certificate contract issuers and only one hundred and four investment funds are registered in Illinois, no attempt will be made in this paper to review the financial requirements under the Illinois Securities Law relating to such issuers.[3]

Three separate methods of securing registration are sanctioned by Section 5 of the Law. Section 5A deals with *Registration by Notification* and provides a summary method of registration for securities which have been registered within the past ten days under the Federal Securities Act of 1933 and which meet an earnings test specified in the Section. *Registration by Description* as provided in Section 5B, is available to issuers which have been registered within the past thirty days under the Federal Securities Act of 1933 which do not meet the earnings test or other qualifications required for Registration by Notification. *Registration by Qualification* is provided in Section 5C, and is available to an issuer in those instances where the securities involved cannot be Registered by Notification or Description.

[2] For a discussion of the background of the Illinois Securities Law See: Young, A New Blue Sky Law for Illinois, The Illinois Certified Public Accountant, December, 1953.

[3] Face-amount certificate contracts are registered under Section 6 and Investment fund shares are registered under Section 7 of the Illinois Securities Law. Respective financial requirements are covered in sub-sections 6A(6) and 7A(11).

In view of the fact that a Registration by Notification or Description can only be accomplished in connection with a registration under the Federal Securities Act of 1933, no separate financial requirements are specified under The Illinois Securities Law for such applications, as the application filed under these sections must contain the same financial statements prepared in accordance with the Federal requirements.

Statutory Requirements

In connection with an application for Registration by Qualification, the financial statements of the issuer which are required in the application are specified in detail in Section 5C1 (j) of the Law.

This sub-section requires that the following financial statements of the issuer be submitted:

(i) A balance sheet as of a date within 120 days prior to the date of submitting the application. If such balance sheet is not certified by an independent public accountant, the prospectus shall also contain a balance sheet certified by an independent public accountant as of the close of the issuer's last fiscal year, unless such fiscal year ended within 120 days prior to the time of submitting the application, in which case the certified balance sheet may be as of the end of the preceding fiscal year.

(ii) A profit and loss statement for each of the issuer's 3 fiscal years (or for the period of existence of the issuer if less than 3 years) next preceding the date of the certified balance sheet and for the period, if any, between the date of the certified balance sheet and the date of the most recent balance sheet. Such statement shall be certified by an independent public accountant for the periods ending with the date of the certified balance sheet.

(iii) An analysis of each surplus account of the issuer for each period for which a profit and loss statement is filed, certified by an independent public accountant for the periods for which certified profit and loss statements are submitted.

(iv) An analysis (which need not be certified to by independent public accountants and which may be in narrative form if desired by the applicant) of all surplus accounts of the issuer for a period beginning on a date not less than 8 years prior to the date of the certified balance sheet required by the above sub-division (i), or from the date of the organization of the issuer, whichever is later, and ending on the day before the first day of the earliest period covered by the analysis of surplus accounts furnished pursuant to the above sub-division (iii).

In addition, if the issuer owns at least 50% of the voting stock of one or more subsidiaries, sub-section 5C-(1)(k) requires like financial statements for each subsidiary or consolidated statements for the issuer and its subsidiaries.

Rules

To implement these statutory requirements the Secretary of State has promulgated Rule B of the General Rules and Regulations under the Illinois Securities Law which governs the form and content of financial statements.

Rule B states the requirements applicable to the form and content of all financial statements required in connection with an application to register securities by qualification. Important terms, such as "control", "material", "Principal holders of securities" and others are defined; the qualifications of the certifying accountants are discussed; requirements for the accountant's certification are outlined; and

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rules of general application are included.

Under the heading "Rules of General Application" particular attention should be paid to Rules 3-16 and 3-17 dealing with general notes to the balance sheet and profit and loss statements. The information required to be set forth in footnotes is specified. Applications have been received by the Securities Division which have failed to include adequate footnotes under these rules, and on occasion applications including financial statements devoid of footnotes have been filed. As a matter of fact, applications have been filed which not only failed to include footnotes to the financial statements, but also failed to include a certified balance sheet and profit and loss statements.[4]

Rule B also contains the requirements for consolidated and combined statements; the content and statement of surplus and the form and content of schedules which are required as a part of the application. Separate requirements for commercial and industrial companies; commercial, industrial and mining companies in the promotional, exploratory or development stage and for committees issuing certificates of deposit are outlined in the rules. In each case the items which shall appear in the balance sheet and profit and loss statement are listed.

Space limitations do not permit a detailed discussion of these various requirements but at least one of these requirements, that relating to the qualifications of certifying accountants, is worthy of a brief discussion. The Secretary of State will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his residence or principal office. Further, the Secretary of State will not recognize any person as a "public accountant" who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

In 1957, the registration of a mechanical tooth brush firm was suspended after an investigation revealed that the financial statements were not prepared by a certified public accountant.

The certifying accountant must not only be a certified or public accountant, but must also be independent. For example, an accountant will not be considered independent with respect to any person, in whom he has any financial interest, direct or indirect, or with whom he is or was during the period of report, connected as a promoter, underwriter, voting trustee, director, officer or employee. In determining whether an accountant is in fact independent with respect to a particular registrant the Secretary of State will consider "all relationships between the accountant and registrant."

Any accountant who prepares or certifies a financial statement in connection with an application for registration must submit a written consent to the use of the material and his name as an exhibit to the application as must any expert who supplies information or prepares or certifies a report or other document filed as a part of the application for registration.

Registration Forms

Instructions as to financial statements are included in each of the forms prescribed by the Secretary of

[4] See 1957 Annual Report of The Securities Division, page 16; 1956 Annual Report of the Securities Division, page 14.

tate in making an application for egistration by qualification under ection 5C of the Law.

The Secretary of State has promulated six forms under Section 5C, nree of which relate to the registraion of oil and mining interests and re rarely used. Of the remaining nree, Form 5C4 is for the registraion of securities issued in respect of tock purchase plans. Illinois Form C2 is to be used for the registration f securities if, among other things, ne issuer has never had any substanial gross returns from the sale of roducts or from services, has never ad any substantial net income from ny source in any fiscal year, has ever succeeded to a going business nd does not presently intend to suceed to any such business. Form 5C1 s to be used for the registration of ecurities which are not required to e registered on any other form.

Detailed "Instructions as to Fiancial Statements" are included in ach form, copies of which are avail-ble on request from Secretary of tate Charles F. Carpentier.

Preparation of Financial Statements

If problems are encountered, either as to form or substance, in the preparation of the financial statements, it is suggested that a conference be arranged with the Securities Division at which time the attorney and the accountant may discuss, in advance of filing, the problems which the attorney and the accountant have encountered in the preparation of the application. In many cases, these problems can be resolved in a staff conference with the Securities Division in advance of filing and save many hours of work and time.

The preparation of financial statements for a registration statement not only affords the accountant an opportunity to cooperate with the attorney who is responsible for the preparation of the application, but in many cases such cooperation is mandatory to produce a good registration statement. In view of this, it is recommended that the accountant read the entire prospectus section of the registration statement sometime prior to the filing of the application with the Secretary of State.

This seems to us the ultimate in editorial self-protection: In Kaingaroa, New Zealand, the local paper concludes each issue with the words, "Opinions expressed in this periodical are not necessarily condoned or even understood by the editorial staff."

—Quote May 1, 1960

The Elective Entity Enigma

By Kenneth E. Pickens

There has been a general feeling for many years, both by tax practitioners and businessmen in general, that entirely too many business decisions are, of necessity, resolved on the basis of the tax consequences involved. This criticism, in particular, has been directed toward the fact that businesses have not been able to select the form of organization desired without making a paramount consideration the differences in income tax consequence. I would like to suggest that as long as we have a rate structure as burdensome in many areas as that which presently exists, the problem of having tax consequences play a dominant role in business decisions will continue. This notwithstanding, the Congress in 1954 attempted to eliminate a portion of this problem by permitting proprietorships and partnerships, by election, to be taxed like corporations. To complement this provision, in 1958, the law introduced the Subchapter S election permitting certain taxable income and net operating losses of a corporation to be passed through to its shareholders. This paper is primarily concerned with the accounting problems which emanate from the Subchapter S election.

Basic Provisions of Subchapter S

In order to consider properly the accounting problems involved, it is necessary to review some of the more basic provisions of Subchapter S. It has been pointed out, and rightly so in my opinion, that the election permitted by this subchapter is not the panacea first assumed by many of us; nor is it one to exercise except upon very careful consideration of the wording of the statute, the intent of the Treasury department as reflected in the regulations, and the multitude of practical tax and accounting problems created thereby. It should also be kept in mind that Subchapter S does not permit electing corporations to be taxed as partnerships, but rather it creates an entirely new and distinctive form of entity for income tax purposes only.

The services have indicated that the election is available to "simple, all-American corporations with few stockholders." The code provides that any small business corporation may elect in accordance with provisions of section 1372, not to be subject to the regular corporation taxes. The term "small business corporation" is defined in section 1371 as follows:

"A domestic corporation which is

)t a member of an affiliated group .s defined in section 1504) and which)es not—

(1) have more than 10 shareholders;

(2) have as a shareholder a person (other than an estate) who is not an individual;

(3) have a nonresident alien as a shareholder; and

(4) have more than one class of stock.''

)me of the seemingly straightrward statements of section 1371 ve produced some unexpected probms. In the case of the number of areholders, the question immediely arose as to the method to be ed in calculating the number of areholders where a particular holdg of stock involved a joint or seval holding. The proposed regulations dicated that each person having an terest in the stock, regardless of the rm of common ownership, constited a shareholder. This situation as taken up in the 1959 amendments hich provided that for purposes of etermining the number of sharelders under section 1371, stock hich is community property of a usband and wife (or the income om which is community income) der the applicable community propty law of a state or is held by a usband and wife as joint tenants, nants by the entirety, or tenants in mmon shall be treated as owned by ie shareholder. It should be carefully)ted that the amendment deals only ith section 1371 and only with com)n ownership involving a husband id wife.

The regulations have clarified the ipulation that a small business cor)ration is one which does not have ore than one class of stock. The regutions provide that in determining hether a corporation has more than ie class of stock, only stock which is issued and outstanding will be considered. Thus, treasury stock and unissued stock of a class different from that held by the shareholders will not disqualify a corporation under section 1371. The outstanding shares of stock must be identical with respect to the rights and interest which they convey in the control, profits and assets of the corporation. The regulations then pitch a curve of substantial proportions by stipulating that if an instrument purporting to be a debt obligation is actually stock, it will constitute a second class of stock. Thus, it appears that an item which is on its face a debt instrument but which is held for tax purposes to be equity, apparently is a second class of stock and will eliminate the eligibility of a corporation to elect the provisions of Subchapter S. In appropriate situations, this should be given very careful consideration.

The section of the code, 1372, dealing with the election itself provides in general the method and mechanics required in making the election. These rules are quite specific and should be scrupulously adhered to in order to make a valid election. This section also deals with termination under the following headings:

(1) New shareholders

(2) Revocation

(3) Ceases to be a small business corporation

(4) Foreign income

(5) Personal holding company income

Without going into detail, there are some important considerations in this area. It is important to note the distinction between voluntary and involuntary termination with respect to the effective date of termination. A formal voluntary revocation involving shareholder concurrence must be made within 30 days after the begin-

ning of the taxable year or before the beginning of that year to be effective for the period. Thus, a voluntary revocation cannot be retroactive to the beginning of the year if made after the first 30 days nor can it apply to the first taxable year for which the Subchapter S election is effective. Contrast this with the fact that termination which results from the happening of events specified in the statute is retroactive to the beginning of the taxable year in which the event occurs. This distinction has given rise to a number of interesting possibilities. It seems apparent that the Internal Revenue Service will scrutinize carefully the substance of those events and circumstances which cause termination of the election retroactive in effect. This intention on the part of the revenue service is evidenced by the requirements in the regulations that all facts be forwarded to the appropriate district director which are pertinent to a termination resulting from failure of a new shareholder to consent to the election or where a corporation ceases to be a small business corporation.

Undistributed Taxable Income

At this point it is probably in order to review briefly the scheme of taxing income directly to shareholders under Subchapter S and to examine this new concept of *undistributed taxable income*. The code provides in section 1373 that each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year. For this purpose, the amount so included shall be treated as an amount distributed as a dividend on the last day of the taxable year of the corporation. You note in the foregoing code provision the use of the term "undistributed taxable income". In general terms, this item is arrived at by subtracting cash distributions which are equivalent to dividends from the corporation's taxable income. For this purpose, the corporation's taxable income is determined without regard to the net operating loss deduction and certain other deductions. The computation is determined as of the last day of the corporation's taxable year and one need be a shareholder only on such last day to have his pro rata share of the undistributed taxable income taxed to him.

As was noted previously in regard to the revenue service's intent to scrutinize carefully events or circumstances terminating retroactively the election under Subchapter S, it appears likely that a similar inquiry will be made into this area of income allocation. The regulations relating to section 1373 indicate that a donee or purchaser of stock in a corporation is not considered a shareholder unless such stock is acquired in a bona fide transaction and the donee or pur

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haser is the real owner of such stock. he regulations further provide that ie circumstances, not only as of the me of the purported transfer but lso during the periods preceding and ollowing it, will be taken into conideration in determining the bona des of the transfer. Transactions beween members of a family will be losely scrutinized.

Undistributed taxable income which as previously been taxed to the hareholders is segregated from accuulated earnings and profits and laced into a special surplus account. does not become part of the tax oncept of accumulated earnings. Unistributed taxable income can be ithdrawn taxfree by, and only by, ie shareholders who included the unistributed taxable income in their ncome.

istributions

To complete the background of me of the more importnat tax conderations involved in Subchapter S, e general classification of distribuons should be reviewed. While the lection is in effect cash distributions shareholders are deemed to have en first from current earnings and ofits, then from undistributed taxle income and finally, from accumuted earnings and profits. It can be en from the foregoing that undisibuted taxable income can not be thdrawn until all current earnings d profits have been distributed. Beuse of this situation, it is well to nsider the advantage in distributing xable income during the corporaon's current year in order to prevent e creation of undistributed taxable come. The order of distribution ter the termination of such an elecn is first, distributions out of current earnings and profits; second, distributions out of accumulated earnings and profits; lastly, tax-free distributions out of undistributed taxable income. The order of distribution indicates a problem where a termination is retroactive to the beginning of the year. Then distributions which might have been intended out of undistributed taxable income become first distributions from accumulated earnings and profits.

Accounting Problem

The general consideration of some of the tax factors involved in the Subchapter S election gives a background against which we can consider some of the accounting problems created thereby. To repeat a comment made earlier, this election should be exercised only after very careful consideration of some of the obvious practical difficulties involved.

Once the election has been made it will be necessary to maintain on the corporation's records a breakdown of undistributed taxable income by the individual shareholders involved. This is in conformity with the idea that undistributed taxable income does not in the tax concept become part of accumulated earnings and profits. In view of the fact that the shareholder reporting the undistributed income on his individual return is the only one who can withdraw the amount tax free, it becomes important that the undistributed taxable income be identified directly with the individual shareholders involved. This will permit a determination of the taxable status of future distributions. It would seem to follow that if a shareholder disposes of his stock after having reported undistributed income under this election, the segregation

of his portion of such income ceases to enjoy any tax benefit with respect to a subsequent distribution. In this general connection, it would probably be logical that the corporation maintain a record of the adjusted bases of the stock for the individual stockholders. In the balance sheet presentation of the equity section it does not seem necessary to make the segregation just referred to as being appropriate in the corporation's general ledger. The customary presentation of retained earnings is in order.

Disclosure

The primary disclosure of the election status is, in my opinion, best set forth in a footnote, or footnotes, to the financial statements. The possible wording of a basic footnote might be along the following general lines:

> The company has elected, under provisions of the internal revenue code, to have its income treated for Federal income tax purposes substantially as if the company were a partnership. The net income of the company will be reported by the shareholders on their individual tax returns. Accordingly, there has been no provision made for Federal income taxes in the accompanying financial statements.

Additional information could be incorporated in the foregoing footnote with respect to the problem of income comparability with prior accounting periods and/or the problem of future dividend withdrawals or possibly advances to shareholders to assist them in paying their personal income taxes on the earnings of the corporation. In this paper, disclosures dealing with these problems are discussed later.

In Chapter 2 of Accounting Research Bulletin No. 43 is set forth the accepted position that the usefulness of reports is enhanced by the presentation of comparative financial statements. In this bulletin it is further pointed out that any change in practice which affects comparability should be disclosed and that prior year figures shown for comparative purposes be in fact comparable with those shown for the most recent period, or that any exceptions to comparability be clearly brought out. It is in conformity with this accepted practice that the operating data for the newly electing corporation must be presented so that the possibility of misinterpretation will be minimized. In my opinion, adequate disclosure can be attained primarily through the use of footnotes. In the presentation of comparative income information, a suggested solution would be to show the comparable amounts of net income before provision for Federal income taxes, in addition to the final net income, for those years not covered by the election. The footnote would explain the absence of Federal income tax provisions in those years covered by the election. It has been suggested that the amount of Federal income taxes which the corporation would have paid if the election had not been made could be disclosed. This type of information would have particular significance in the year of change and could be included in the footnote. I think the important point in the income comparisons would be to be sure to show income figures prior to income tax provisions and then give other data considered pertinent in the footnote. It would follow that the same degree of care would be involved in computations presenting earnings per share.

Shareholder Withdrawals

An accounting problem that arises in this general area involves the possible withdrawals by shareholders for

ne payment of their personal Federal ncome taxes. It should be kept in nind that the election does not change he legal entity of the corporation, nd in general, such funds would nor- ıally be obtained by the payment of ividends. It is a possibility, of course, ıat loans to shareholders might be ıade for this purpose. The selection f this latter method in itself poses roblems. It would seem, however, ıat in either instance the usual prin- ıples of disclosure of significant vents subsequent to the balance sheet ıte would suffice. In other words, if ıere are definite plans involving ithdrawals of funds or if the direc- ›rs have indicated their intention to eclare certain dividends this should e disclosed. Naturally, if dividends ıve been declared prior to the end the accounting period, any unpaid ›rtion would appear as a liability in ıe balance sheet. Where there is no efinite plan for distributions or ad- ınces to shareholders, a statement ›uld be included that no effect has een given to such amounts which ay be advanced or distributed to sist shareholders in paying personal x obligations. The important point that inquiry should be made and e significant facts disclosed.

As a practical matter, in situations this type involving tax problems of areholders of closely-held corpora- ons, the company could and probably ›uld keep records supporting the ljusted bases of the stock of the various shareholders. In addition, a company operating under this election would want to provide the shareholders detailed information with respect to taxable income per share and a breakdown, if any, between capital gains and ordinary income.

Prior Income Tax Allocations

Another accounting problem which presents itself as a result of the election under Subchapter S is the proper disposition to be made, if any, of the results of income tax allocation entries made in prior accounting periods. The most common example would be a situation wherein some method of accelerated depreciation has been used for tax purposes but not for accounting purposes. This type of arrangement, if the amounts involved are significant, could have given rise to a deferred income tax liability, or possibly, an increase in the accumulated depreciation accounts. In the first instance, involving a deferred income tax balance, it would be acceptable, in my opinion, to eliminate this balance and items shown "net of taxes" increased to their full amounts. If in periods prior to the election, the problem referred to has been handled as an adjustment of depreciation the unrecovered costs involved could be spread over the remaining life of the assets beginning with the first year of election under Subchapter S.

History with Supervision— Savings and Loan Associations

By Crofford Buckles

At a recent annual convention of the Illinois Savings and Loan League, one speaker remarked: "Supervision is as old as government itself," and he might have added, "It is as tenacious and insidious in its growth, once it is fastened to an industry."

Early Years of Supervision

It is interesting to know that in the Savings and Loan industry, according to a report of the Auditor of Public Accounts in 1944, the first request for supervision came from the industry itself and not from the state authorities. This happened in 1891 when a law was passed requiring associations to file annual statements with the Auditor of Public Accounts and providing for examinations, upon request of nine or more shareholders or when deemed necessary by the Auditor. Two years later the statute was amended making the annual examination by the auditor mandatory.

In these early years, the associations were called: "Building and Loan Associations" or "Building, Loan and Homestead Associations", because they were chartered under the Mutual Building, Loan and Homestead Act of the State of Illinois. Under the provisions of that statute supervision of all associations chartered under the act was vested in the office of the Auditor of Public Accounts. The statute further required that the secretary of every association file with the Auditor of Public Accounts, within sixty days after the close of its fiscal year, a detailed financial statement. It also provided that the accounts of the association should be examined.

From time to time, the office of the Auditor of Public Accounts, Building and Loan Department, under the direction of a Chief Examiner appointed by the Auditor, has issued rulings or directives pertaining to the operation of the associations. These became guide-posts for the examiners as they went about on their assigned program. These rulings also have become useful to the certified public accountants as the audit program has developed.

ederal Home Loan Bank ssociation

In 1932, the Congress passed the ome Owners Loan Act officially de- ribed as "an act to create Federal ome Loan Banks, to provide for the ipervision thereof, and for other urposes". This Act further provided or the organization of, and author- ed the issuance of charters to, ederal Savings and Loan Associa- ons, and for the supervision and eriodic examination or audit of these ederal Associations by examiners for e Federal Savings and Loan Insur- nce Corporation, which agency was t up to insure the accounts of these sociations. Later amendments were lded whereby state chartered asso- iations could qualify for insurance their accounts by the Federal Sav- gs and Loan Insurance Corporation. ne of the conditions for the insur- nce was that the records of the in- red institution should be open to eriodic examinations or audits by aminers for the Federal Savings d Loan Insurance Corporation.

The basis or scope of these examina- ons was set forth in a letter from the ief Examiner of the Federal Home an Bank Administration under date January 15, 1944:

> "The Federal Home Loan Bank Administration does not solicit auditing work of savings and loan associations, for we believe that the decision as to auditors should rest with associations and that the principal function of the Examining Division of the Administration is the making of supervisory examinations. . . . As you know, we confine our annual review of an association to a supervisory examination if the association is audited by a qualified independent accountant, and the Administration must rely completely on the audits by independent accountants when audits are not made by our own examiners."

The letter went on to prescribe certain specific matters to be incorporated in the audit procedure and reports by the independent accountants. These were restated in a letter dated September 15, 1944. On September 10, 1945, some of the requirements set forth in the earlier letter were rescinded and a more detailed and specific list of requirements was prescribed.

Cooperation with CPAs

In those earlier years, and we might well call them the formative years, each supervisory authority sought to be cooperative with certified public accountants. The Auditor of Public Accounts prepared and made available a pamphlet entitled, "General Instructions for Preparing the Annual Statement of Illinois Building and Loan Associations". A second pamphlet was entitled, "Uniform Audit Reports Proposed for Illinois Building and Loan Associations Insured by the Federal Savings and Loan Insurance Corporation". This latter publication set forth in detail the scope of the audit, the form of the audit report and in unqualified terms stated that "its scope must be as comprehensive as hereinafter outlined in order that the accountant can execute verbatim (except for such minor qualifications as may be found necessary) the accompanying certificate". The certificate as prescribed bore little or no resemblance to the certificate approved by the American Institute of Certified Public Accountants.

Not to be outdone by the supervisory authority of the State, the District Examiner for the Federal Home Loan Bank Administration circulated a letter setting forth the scope of audit, the arrangement of the Audit Report, the Auditor's Comments and

ending with the Auditor's Certificate. And again, this certificate resembled neither the certificate prescribed by the Auditor of Public Accounts nor that approved by the American Institute of Certified Public Accountants.

In 1938 the Directors of the Illinois Society of Certified Public Accountants authorized the appointment of a Special Industry Committee to give particular attention to the savings and loan industry. One of the items on the agenda of the first meeting of the original committee was the form of this certificate or opinion which the accountants were requested to sign in connection with the annual report on savings and loan associations. This question continued to receive the attention of this special committee until eventually the certificate or opinion printed on the annual report to be filed with the Auditor of Public Accounts and signed by the accountant was in conformity with the certificate approved by the American Institute of Certified Public Accountants. Under date of July 1, 1954, the Chief Examiner of the Home Loan Bank Board again addressed a letter to all public accountants which, according to their records, were auditing one or more savings and loan associations whose share or savings accounts were insured by the Federal Savings and Loan Insurance Corporation. This letter superseded all previous letters with reference to requirements of the Home Loan Bank Board and restated the minimum requirements:

"1. The audit shall be made by a qualified accountant who is not a director, officer or employee of the association audited, or by a firm of accountan no member of which is a directo officer, or employee of such associ tion, provided that such accounta or firm is approved by the Chief E aminer of the Home Loan Ba Board.

"2. The scope of the audit shall include
(a) Verification of assets;
(b) Determination of the extent of t liabilities;
(c) Verification of income and oth receipts, ascertaining that ceipts are properly recorded a deposited;
(d) Verification that expenses a disbursements are proper;
(e) Satisfactory verification of vestors' accounts by direct c respondence (at least 10 per c in number, the total of wh shall be not less than 10 per c of the aggregate dollar amo of all investors' accounts), ceptions, if any, being report
(f) Satisfactory verification of l rowers' accounts by direct respondence (at least 10 per c in number, the total of wh shall be not less than 10 per c of the aggregate dollar amoun all borrowers' accounts), exc tions, if any, being reported;
(g) Verification of compliance w reserve requirements under Rules and Regulations for In ance of Accounts, and with C ter requirements;
(h) Analysis of the system of inte check and control, with ap priate comments regarding adequacy or inadequacy; also analysis of the accounting sys with appropriate comments a any material exception to or viation from sound accoun practice."

It is noteworthy that Item 3 st simply:

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"3. The audit shall contain a certificate by the accountant that in his opinion the statements contained in the report are correct."

This is not to say that the supersing authorities have exceeded the uthority granted to them. It is quite vident that supervision of the activies of the industry has been expanded include direction of the scope of ie audit of these associations to be ade by the independent accountants nd to prescribe the type and the form the audit report to be prepared, and e believe this was not the intent of ie provision for supervision. The ccountant has little choice but to mply because, "If the report is not ceptable, the examiners for the Fedal Home Loan Bank Administration ill make a complete audit," thus ubjecting the association client to lded expense.

ecent Problems

The events of more recent years ave not helped the situation. We saw most a complete breakdown of the xamining staff of the Auditor of ublic Accounts, Building and Loan epartment. A direct result was a disontinuance of the joint examination rogram. Events in other sections of e nation pointed many fingers at the xamining Division of the Federal ome Loan Bank Administration. To ounteract this, the examining proram was expanded and the report of e independent accountant was given ttle consideration. The examining aff was enlarged, and in many stances the qualifications of the xaminers in regard to theoretical ademic training, experience, or maurity of judgment was not sufficient command the respect of those whose counts were being examined. Yet they were given unbridled authority.

In 1952, the exemption from filing corporation income tax returns previously granted to mutual savings, building and loan associations was removed from the Federal Income tax law. So the association, already subject to supervision by the Auditor of Public Accounts and, if their accounts were insured, by the Federal Home Loan Bank Administration, now became subject to a third supervision, that of the Internal Revenue Service. This multiplicity of supervisory authority has resulted in conflicting opinions and rulings and tends to complicate problems for the association. For instance, the office of the supervisory agent, Federal Home Loan Bank Board, sent the following letter to all insured associations under date of June 10, 1958:

"As you know, the Internal Revenue Service recently issued a ruling in substance that savings and loan associations, without incurring any Federal income tax liability, may transfer to undivided profits all or any part of the amounts accumulated in loss reserves as of December 31, 1951. However, this ruling does not alter regulatory provisions. Federal associations are required by charter provisions to maintain and accumulate general reserves for the sole purpose of meeting losses. Federal regulations define general reserves as being established solely for such purpose. Also, the rules and regulations for insurance of accounts require that the Federal Insurance reserve be used solely for the purpose of absorbing losses. There is no difference between pre-1952 and post-1952 credits.

"The Legal Department has always held, and supervision of compliance with reserve requirements has always been on the basis, that no deductions may be made from and no charges may be made to such reserves for any purpose other than to absorb losses. Accordingly, please be advised that transfers to undivided profits or surplus from loss reserves required by Federal charter, by the Federal regulations, or by the Insurance regulations are

not permissible under the regulations, and that any such transfers as may have been made to date must be reversed.''

With the establishment of the Department of Financial Institutions and the reorganization of the examining staff, there is some evidence that the pendulum is swinging back to a more normal position.

Supervision—Present Status

We refer again to the letter of the Chief Examiner of the Federal Home Loan Bank Administration dated January 15, 1944 and the quotation made earlier in this article. We believe this states clearly and completely the interpretation of that provision in the act granting the supervisory authorities supervision over the savings and loan associations. The principal functions of the Examining Division, as stated by the Chief Examiner, is the making of supervisory examinations, and the annual review should be confined to a supervisory examination if the association is audited by a qualified independent public accountant. We do not take particular issue with the detailed requirements or the form of the audit report requested either by the Auditor of Public Accounts or by the Examining Divisio of the Federal Home Loan Bank Ad ministration. It is quite understand able that in the review of the report from many individual institutions i an industry, some degree of similarit would be most helpful to the supe vising authorities, and we can sa without reservation that the requir ments comply with good professiona practice. For the most part, they a a restatement of the principles s forth in the bulletin published by t American Institute of Certified Publ Accountants in 1940 and revised 1951.

With the restoration of this wor ing relationship and an atmosphere cooperation rather than one of dict tion, the position of the independe certified public accountant, followin the audit and analysis of the account again becomes that of a friendly, a visory counsel. As such, he is entire independent, free to criticize whe he sees criticism due and to comme when it has been earned. In so doin he brings credit to himself and h profession and renders a valua service, both to his client and to t supervisory authorities.

Seventeen Suggestions for Additional Use of Your Photographic Reproducing Equipment.

Making Photographic Reproducing Equipment Do Your Work

By Robert Heinsimer

The public accountant, like other businessmen, is finding himself caught in the vise between rising costs and the resistance to increased fees. As a result his profit margins grow narrower unless he can find cheaper or better ways of doing his work. Fortunately, some of the new office devices enable him to reduce his costs without cutting the extent of his services. One such piece of equipment is the photographic reproducing machine.

Most accountants are aware of the usefulness of reproducing machines for tax returns and tax return schedules, so this article is not going to go into that phase of the usefulness of these machines. The purpose of this article is to bring out some of the many other uses, besides tax returns, for reproducing equipment. It must be remembered that there is no single perfect machine on the market for all purposes (except perhaps one make whose cost is prohibitive). Hence, in the paragraphs which follow you must consider whether your machine will perform the function desired. However, a service bureau might do it for you at about the same cost as doing it yourself.[1]

Also, don't forget that in many instances planning of the work in advance for machine reproduction is necessary. With that introduction, here are some seventeen suggestions for the additional use of your photographic reproducing equipment:

1. **Advance copies of journal entries.**
   The client's bookkeeper will greatly appreciate receiving a reproduced copy of the auditor's adjusting journal entries as quickly as the auditor finishes

[1] Some of the service bureau rates for the diazo process, in the Chicago Loop area, including pick-up and delivery for 8½ x 11″ sheets are:

8½ x 11″ Sheets	Amount	8½ x 11″ Sheets	Amount
1	$ .53	40	$3.15
2	.61	50	3.75
3	.69	60	4.25
10	1.25	75	5.00
20	1.95	100	6.25
30	2.55		

A sheet sized 11 x 17″ counts as 1½ sheets of 8½ x 11″. It is the writer's belief that the use of service bureaus at the above rates is very little more costly than running the work yourself when labor is added to other direct costs. However, the control of the original material and better quality of work obtained, besides expanded uses not obtainable from service bureaus, makes ownership of this type of equipment desirable.

closing his working papers. This enables him to proceed with his work promptly. It also saves the accountant the expense of typing the journal entries.

2. **Advance Working Copy of Report for Client.**

A client, impatient for his audited figures, will frequently appreciate a photographic copy of the auditor's statements before they are typed.

3. **Monthly Comparative Figures Reproduced.**

Many clients are very happy to get monthly figures in comparative form on a 13-column work sheet. If the monthly adjustments are put on the books, the auditor may take off his statements as a by-product of his trial balance. Reproduction of this monthly trial balance will give the client good comparative figures very speedily at great economy to the auditor.

4. **Give Client Copy of Important Working Paper Schedules.**

Certain working paper schedules are of great value to the client and can be furnished him by reproducing. For example, we furnish a law firm with several copies of its aged accounts receivable trial balances quarterly. The partners use these for their meetings and collection follow-up purposes. The auditor's schedule of fixed assets or repairs or other working paper schedules may be of great value to management, and if furnished by the auditor, tend to build up client good-will. The working schedules can be submitted the client at small cost to the auditor.

5. **When Much Information Is Required and with Speed—Reproduce!**

Certain types of jobs, such as lawsuits, purchase of businesses, etc., require a great deal of information quickly. The lawyer or purchaser will appreciate the speed and completeness of the information you are able to submit by photographing your notations and working schedules. These jobs particularly require that auditors plan in setting up notes and schedules for reproduction purposes.

6. **Form Letters and Client Informati Letters.**

Letters of transmittal for tax retur letters to clients giving new tax da etc., can be reproduced on your rep ducing machines. Of the photograph machines, those using the diazo proce are best for this.

7. **Extra Copies of Report.**

If you find that an extra copy of t report is needed after typing is co pleted, your photographic equipmc may produce the desired results. T diazo process may be used satisf torily for reproducing the entire rep from a single master, saving the di culties of multiple carbons or running.

8. **Tax Data to and for Clients.**

On particular points of tax interest clients, send them photographic rep ductions of the case or ruling involv Likewise, put photographic reprod tions of pertinent rulings or cases your client's tax file for speedy fut reference.

9. **Extra Blank Forms.**

Insurance companies, governmen agencies, credit agencies, etc., m times follow the short-sighted prac of sending single forms which they pect you to return. If you wish to t your report, photograph the bla make your pencil copy, and type original. Then photograph the ty copies for as many additional co as are needed.

10. **Answering Letters.**

A letter containing many questions frequently be answered expeditio by noting answers in margins and producing the original letter with marginal notes.

It is frequently helpful in corresp ence to send a reproduced copy of original letter back to your co spondent. It saves your correspond the necessity to refer to his files speeds replies.

11. **Supplementary Invoice Files.**

Many clients insist on keeping t invoice files intact, whereas it may desired to have special purpose inv files for audit purposes (such as f

asset additions). If your client has reproducing equipment it may be possible to reproduce for his regular invoice file the special invoices and then keep the original invoices in a special folder for audit purposes.

12. **Reproducing for the Client.**

In certain instances we reproduce on our equipment several copies of the companies' financial statements prepared in pencil by the companies' bookkeepers and mail them back to the client as a special good-will service for the client.

13. **Questioning Matters on an Invoice.**

From time to time during the course of an audit it may be desirable to raise a question with respect to an invoice, either with management or a vendor. By reproducing the questioned invoice the original invoice can go back in the files and the vendor or manager can have the invoice in question put before him at your convenience.

14. **Copying Contracts or Minutes.**

Frequently it is desirable for the auditor to have excerpts from minutes or contracts. By use of the photographic process considerable time is saved and there is no question as to the accuracy of the excerpt.

15. **Captioned Work Sheets or Statements.**

Where it is desired to type statements for clients, and in those situations where accounts and account titles do not change frequently, it is possible to prepare blank trial balances and statements in pencil one time on a type of paper which you can reproduce. Photograph these figureless blank statements each year and use the reproduced copy for filling in your figures and working papers. These blank statement forms without figures (by some firms called "dummies" and others "pro forma") can be reproduced year after year for the working papers.

16. **Recurring Schedules for Working Papers.**

Certain working papers schedules do not change materially from year to year. Examples are prepaid insurance. lease schedules, etc. Reproduce the pencil copy of such schedules and use the reproduced copy as the working paper schedule. In the subsequent audit make the necessary changes in the pencil copy of the previous year by erasing (lease schedule, insurance schedule). Now reproduce this changed schedule for this year's working papers.

17. **Requests for Additional Income Tax Data from Clients.**

In the course of preparing income tax returns for clients we frequently find that there are several matters on which the client has not furnished adequate information. We list these questions on a work sheet allowing room for the client's answer between each question. We reproduce two copies of the work sheet and send them to the client for an answer. He retains one copy and returns one copy of the answered questions to us.

At one time or another our reproducing equipment (a Thermofax and Bruning) has been used for all the purposes stated. We expect to develop many other uses as time goes on. Clients appreciate the fact that a great quantity of additional information is placed before them much more quickly and at considerably less cost than if we were to use other methods of presenting the desired information.

ROBERT HEINSIMER is a partner of Robert Heinsimer & Company, Certified Public Accountants, Chicago, Illinois. He has been an active member of the Illinois Society's Local Practitioners Committee.

Recent Developments Affecting Social Clubs

After a period of relative inactivity, as far as social clubs were concerned, the Internal Revenue Service recently issued proposed regulations and several Revenue Rulings affecting social clubs in particular.

Tax-Exempt Status

It is probable that widespread attention will be given to Revenue Ruling 60-324, which stated the position of the Internal Revenue Service as to the extent to which a social club exempt from Federal income taxes under Section 501 (c) (7) of the Internal Revenue Code of 1954 could make its club facilities available to outside organizations and groups and still retain its tax exempt status.

The Ruling, in citing Section 1.501 (c) (7) -1 of the Income Tax Regulations, indicated that a club could lose its exempt status if its facilities were made available to the general public. This does not necessarily mean that any dealings with non-members will automatically cause the loss of the tax exempt status by the club. Tax exempt status can be maintained even if the club receives some income from the general public, or if the general public is permitted, occasionally, to be active or to participate in the affairs of the club, provided that (1) this is incidental, (2) it aids the general club purpose, and (3) the income does not benefit the members. "General public" is defined as persons other than members and their bona fide guests.

Reference was made in the above ruling to Revenue Ruling 58-589, and cases cited, where the same general conclusion was reached. If, for example, the receipts from non-members were not more than enough to pay the corresponding share of the expenses it could not be said that the income benefited the club or the members.

On the other hand, Revenue Ruling 58-589 held that, where a club made its facilities available to the general public with the purpose to increase its funds for enlarging the club being otherwise of benefit to the members, it was evident that such organization was not operating as a tax exempt social club within the framework of Section 501 (c) (7) of the Internal Revenue Code.

In Revenue Ruling 60-324, the club in question had a considerable number of functions which used its private dining rooms and ballrooms. These functions included civic and business club meetings, employee parties, business firms, school and alumni banquets and parties, and similar non-club activities.

A member of the club sponsored the organization or group, and all negotiations for the use of the club were made with that particular club member. The club records showed the member as the party responsible for the behavior of the guests, the protection of club property, and for the bill. He was billed by the club and apparently was reimbursed by the organization or group for which he was the sponsor.

An independent report on the amount of business done by the club indicated that the income from the sales on behalf of outside organizations and group arrangements ranged from 12 to 17 percent over a seven year period. In one year, over 200 outside functions were held at the club which accounted for approximately 25 percent of the total gross profit of the club during the year. The report indicated that if the club had discontinued the outside functions a substantial increase in the amount of club dues from club members would be required. The outside functions were not discontinued, although the amount of dues was increased because of rising costs and other factors.

The Revenue Ruling concluded that the club by making its social facilities available to the general public through its member-sponsorship arrangements could not be treated as being operated exclusively for pleasure, recreation or other non-profitable activities. Accordingly, it was held that the club no longer qualified for exemption from Federal income tax under Section 501 (c) (7) of the code.

With the issuance of this ruling it is likely that closer attention will be paid by the Internal Revenue Service as to whether the requirements relating to the tax exempt status are met. In order to retain their favorable tax exempt status, many social clubs are now considering an analysis of their present policies in light of the Ruling. Several trade associations have been quite active in the past in attempts to seek revocation of the tax exempt status of certain social clubs whose social and recreational facilities are made available to the general public, to the detriment of members of the trade association.

Proposed Regulations

Proposed regulations under Code Section 4241, 4242, and 4243 relating to the excise tax and club dues, were published in the Federal Register, September 23, 1960. Of paramount interest at this time is Section 49.-4243-2, dealing with the exemption from tax on payments for capital improvements.

In both 1958 and 1959 Congress approved exemption from the Federal Club Dues tax of 20%, first by exempting from the tax any assessment paid for capital additions or capital improvements, and then by including dues and initiation fees in the exempt category when used in conformance with the requirements of the code.

The committee report on Public Law 85-859 (1958) stated that the assessments used for the purchase of land would continue to be taxable and that the use of funds for the purchase of existing facilities would also be taxable. The exemption was available only to the construction or reconstruction of buildings as well as outdoor facilities such as: tennis courts, swimming pools, and golf courses. Mere upkeep and maintenance did not constitute construction

or reconstruction, and failed to qualify as tax exempt expenditures.

In 1959, by Public Law 86-344, a desirable modification was made by allowing dues and initiation fees as well as assessments used for capital improvements to be exempt from taxes. Section 4243 (b) of the Internal Revenue Code, as amended, presents favorable tax relief to clubs or to the members, when its provisions are followed.

During the past two years, since the exemption amendments were passed, many clubs embarked on programs of expansion, desiring to utilize relief measures available under Section 4243. However, in view of the brevity of the committee reports, and the lack of regulations or decisions, many clubs hesitated to act without attempting to obtain rulings from the Internal Revenue Service befitting their particular case. Now, with the issuance of the regulations, some questions are resolved, but others are still uncertain and probably will be the subject of future Revenue Rulings.

The proposed regulations provide that the assessments paid during the period from January 1, 1959 to October 31, 1959, to be used for the construction or reconstruction of any social athletic or sporting facility, would be exempt from the tax provided that the capital improvements began after December 31, 1958. During the period stated above, the assessments, to be tax exempt, could be used only for buildings and any appurtenances and for tennis courts, swimming pools, golf courses, etc. The exemption does not include items of personalty such as furniture, fixtures, vehicles, mechanical electrical appliances, etc.

Amounts paid after October 31, 1959, as dues, membership or initiation fees qualify as tax exempt if used for construction or reconstruction of a facility or a capital addition or capital improvement to such facility begun after December 31, 1958, or for furnishings or fixtures such as furniture, drapes, carpets, electrical appliances but only to the extent that such items are required by reason of the construction or reconstruction as mentioned above.

The amounts paid for retirement of an indebtedness, such as a mortgage loan, if incurred by reason of improvement or purchase of furniture, furnishings or fixtures in connection therewith would also be exempt from tax, as would amounts paid for replenishment of reserve funds expended by the club for tax exempt purposes. The purchase of land or of existing facilities is not tax exempt in the proposed regulations as was voiced in the committee report. The regulations also state that the amounts paid for ordinary maintenance or repair of club facilities do not come within the tax exemption. While no definition is made as to what is ordinary maintenance or repair, it is probable that the usual standard for expensing items as ordinary maintenance or repair should be followed.

The proposed regulations provide that amounts paid are not within the tax exemption unless they are ear

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DALE B. WATERLOO, who is a partner of the firm, Horwath & Horwath Chicago, prepared the comments for this issue.

marked at the time of payment for use as provided in the paragraph. Many clubs, however, are indicating on their statements the capital improvement charges separately from the taxable club dues. The receipts from these charges are deposited in a special capital improvement account which at all times is kept separate from the operating account of the club and only approved expenditures for capital improvements are drawn from this account.

If any amounts are unexpended within three years after receipt by the club, the club rather than the person who has made the payment shall be liable for the club dues tax at 20% on the unexpended amount, in the same manner as if payment had been made on the first day following the expiration of such three year period. It is questionable whether any such amount will remain unexpended in the normal course of club business.

Interest on Improvement Loans

Revenue Ruling 60-315 is important and covers a point not specifically mentioned in the proposed regulations. A club, in order to finance the cost of capital improvements, obtained a loan from a bank and used funds from a reserve account accumulated by the club in prior years. A favorable holding was issued to the effect that the exemption under Section 4243 (b), would apply to the amounts paid by club members for the repayment of the bank loan, including the interest thereon, and for the restoration of the club's reserve fund.

The ruling would apply to specified amounts to be paid by new members as well as the special monthly assessments against all members. The qualification was that the exemption would not apply to the portion of such payment used for the repayment or restoration of the funds used for the payment of the current operating expenses or for purchases of land, rather than capital improvement financing. To assure the proper application of exemption, therefore, the club must maintain adequate records to show the actual disposition of funds being restored or repaid.

Tax on Lockers and Other Facilities

A Revenue Ruling 60-108, and the Knoll Golf Club case, 60-1 USTC 76,-487, combine to extend the application of the Federal Club dues tax to amounts paid by members of social clubs.

The Knoll Golf Club sued for refund of Federal excise taxes paid on fees for individual storage lockers used by club members. The court upheld the taxation of lockers as a club facility and denied the claim for refund.

The court held the club could include the locker charge in its membership fee, or handle it separately, but in either event, it was a membership "facility" and taxable under Section 4241 and 4242 of the Internal Revenue Code of 1954 which defines dues to include any charges for social privileges or facilities.

In addition, the court ruled that if the locker fees were not held to be taxable as a "facility," the membership dues could be so reduced by a transfer from taxable to non-taxable charges so as to render the Act unworkable and to frustrate the basic intent of the law.

In Revenue Ruling 60-108, amounts paid to a "hunt" club by its members for the hire of horses, the rental of

horse stalls, and the boarding of horses for its members were held to be subject to the 20% tax also.

Previous Revenue Rulings dealing with the tax on club facilities were reiterated, among the items mentioned were:

1. Any charges made by a social, athletic, or sporting club to its members for the use of any social, athletic, or sporting privileges or facilities for a period of more than six days comes within the meaning of the term "dues" and thus are subject to the tax. (Revenue Ruling 55-318).
2. The term "athletic or sporting privilege or facility" was defined to include the service of cleaning and storage of golf clubs. (Revenue Ruling 56-620).
3. The charges made by a yacht club for the use of boat docking and mooring facilities for a period of more than six days constituted "dues" and were subject to tax. (Revenue Ruling 58-459).

While there has been some favorable tax relief granted by Congress in recent years, this area still contains room for much more. The most desirable relief measure, which would benefit both the members and the clubs, would be a reduction in the present twenty percent tax rate.

AS OTHERS SEE US

"There is also another symptom of the Company's new order of efficiency, but it is perhaps more suggestive than conclusive. In every year since 1955, whether or not its sales volume was temporarily trending up or down, the company has been able to increase its earnings. There are so many ways of accomplishing this by mere bookkeeping tricks that financial specialists are wont these days to view any such performance skeptically. So many costs can at option legitimately be anticipated or deferred, expensed or capitalized, that no corporate earnings figure is now regarded by sophisticates as absolute and objective. Windfalls such as those deriving from favorable market prices for a commodity can have a pleasant but misleading effect on stated earnings so can variations in the rate of remitted dividends received from foreign subsidiaries."

—*Forbes Magazine*, August 1, 1960

The features and uses of the "Manual of Suggested Accounts and Accounting Procedures for Municipalities"

Accounting for Municipalities

By George C. Brook

In response to a recommendation of the Municipal Audit Advisory Board that an accounting manual for municipalities be prepared, the State Auditor sponsored the undertaking. It was prepared largely by CPA members of the Board with the advice and counsel of municipal officer and citizen members.

The manual is addressed specifically to municipal officers, their financial and accounting employees and to independent auditors of municipalities. Along with other objectives, the manual seeks to apply the accounting standards and uniform account classification of the National Committee on Governmental Accounting to the needs of Illinois municipalities. It is hoped that most cities and villages will adopt the suggestions and thus provide adequate municipal accounting data, uniformly gathered and presented. With a sharper accounting of public funds by public officers made possible by these suggestions along with the counsel of independent auditors, more efficiency in government will be the logical outcome.

Features of the Manual

The manual includes the following elements:

1. Background material including accounting and legal requirements of the municipal audit law; a description of types of accounting systems available (cash, modified accrual and accrual); and the implications of fund accounting.
2. Suggested chart of accounts which is a condensed version of Bulletin 17, Standard Classification of Municipal Accounts by the National Committee on Governmental Accounting.
3. Description of groups of accounts and specific accounts and the kind of information to be recorded on them.
4. Outline of the minimum accounts needed by "cash-basis" municipalities.
5. Journal and ledger organization suggestions along with suggested forms.
6. Illustrations of funds involved in and entries in journals and ledgers for typical financial transactions.
7. Illustrations of trial balances and financial statements.
8. Description of commonly encountered

GEORGE C. BROOK, a member of the Society's Committee on Local Government Accounting, prepared this article at the request of the committee. He is the Director of the Bureau of Research and Statistics of the Chicago Board of Education.

municipal funds and a tie-in of these to the chapters and sections of the state law.

9. Topical index.

The manual indicates legal reasons why records must be prepared and how these may be accomplished. Not only is a suggested chart of accounts and description of accounts provided, but a description of journal and ledger organization and illustrations of their use are provided as well. Also, the illustrations of trial balances and financial statements help to promote understanding of the tie-in of these to the accounts. A section on commonly used municipal funds is provided and the topical index supplies a ready reference to the various items covered in the manual.

Usefulness of the Manual

While it is true that nine-tenths of Illinois municipalities are small "cash-basis" communities with restricted activities and could not use the manual to its fullest extent, nevertheless they can to a degree condense their accounting system to meet their "cash-basis" needs. Also it should not be overlooked that the fewer but larger municipalities that can use the manual fully, carry on most of the state's municipal activities and spend most of the state's municipal revenues.

The great value of the manual is in focusing accounting methods and procedures to the legal and accounting requirements of Illinois municipalities.

THE ERROR

The editor of a small-town weekly was severely criticized because of an error in his paper. His comment was:

"Yes, we know there were some errors in last week's paper. We will further agree that there were some errors in the issue of the week before, but before bawling us out too unmercifully about it, we want to call your attention to these facts: In an ordinary newspaper column there are 10,000 letters, and there are seven possible wrong positions for each letter, making 70,000 chances to make errors and several million chances for transpositions. There are 48 columns in this paper, so you can readily see the chances for mistakes. Did you know that in the sentence, 'To be or not to be,' by transpositions alone 2,759,022 errors can be made? Now aren't you sorry you got mad about that little mistake last week?"

—Ohio CPA, Autumn, 1959

Conducted by the Committee on Local Practitioners of the Illinois Society of Certified Public Accountants

Ideas for Accountants

WORKING PAPER STYLES

The use of the side bind 8½ x 11 size working paper offers many advantages. Most of the legal size working paper have 44 lines, whereas the letter size (8½ x 11) has 41 lines. Where, then, is the difference in size made up? The legal size top bind has two inches of space at the top, whereas the side bind has one inch. The height of five units on legal size work paper is 1¼ inches, whereas the letter size has 1⅛ inches for five units. The difference in columnar width of comparable papers of the two sizes is about 1/16 of an inch. You will find that figures are not more cramped on the letter size paper than on the legal size. It is very seldom that one will find that the three line difference causes any difficulty since it is very rare that one uses the full sheet of paper.

Here are the bonuses that one gets from the use of letter size working paper:

1. These sheets are side punched on the eleven inch side to fit standard ring binders. Thus, your working papers on a job can be housed in a ring binder and sheets inserted or removed in any position from the pile of papers at any time. It is also possible to obtain very inexpensive ring binders to use as permanent file binders.

2. Papers can be filed in letter size files which are 15 inches wide as against legal size which are 17¾ inches wide, thus saving considerable valuable floor space. The letter size files are, of course, less expensive than the legal size.

3. Index tabs, either Kraft or insertable, can be purchased readily and at relatively low cost to improve the workability of your files.

4. All rulings of the top bind (14 columns, 21 columns, etc.) can be obtained in double and triple size sheets of the basic letter size in width. In addition, certain sheets are obtainable in the side bind forms only. For example, an 11 x 16⅜ sheet is obtainable which binds at the 11-inch side, and the columns run down the 16⅜-inch side. This sheet contains 61 lines.

5. Certain photographic equipment is made with 11 inch throats, and while they will take an 11 x 17 work sheet or an 11 x 25 work sheet, they cannot be used with 13 x 17 sheets (*e. g.* Bruning Models 100, 105, & 110). Further, the cost of photographing the smaller letter size sheets is less than the similar cost for legal size sheets.

LETTERS OF TRANSMITTAL

Writing letters of transmittal telling the client exactly what to do wit a governmental form can be a time consuming operation during busy period Here is a transmittal form which is designed[1] as a letter of instructions the client and which can be used with almost any governmental form. F those accountants who believe that all matters which go to a client must l individually typed, this form can be used as an instruction sheet for th stenographer in lieu of individual dictation.

INSTRUCTIONS FOR FILING

(Items Checked)

☐ 1040 ☐ 1040ES ☐ 1041 ☐ 1065 ☐ 1120 ☐____

SIGN:

- ☐ At place___marked "X."
- ☐ Both husband and wife.
- ☐ Insert date.
- ☐ Insert corporate title.
- ☐ Affix corporate seal.
- ☐ Have signature notarized.
- ☐ _____

RETAIN FOR YOUR FILES:

- ☐ Copy(ies) provided
- ☐ Upper portion to be detached.
- ☐ Other papers enclosed.
- ☐ _____

PAY THE TAX DUE AS FOLLOWS:

- ☐ Attach your check for $_____payable to the Internal Revenue Service.
- ☐ Attach your check for $_____payable to _____
- ☐ Pay the balance in installments as follows:

  _____ $_____

  _____ $_____

  _____ $_____
- ☐ No tax due.
- ☐ _____

MAIL THE ORIGINAL:

- ☐ In the enclosed envelope.
- ☐ To _____

This Return Is Due on or BEFORE

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[1]Prepared by Arthur Witte of Lester Witte & Co, CPA's, Chicago, Illinois.

ROBERT HEINSIMER, of Robert Heinsimer & Company, and ARTHU WITTE of Lester Witte & Company, both firms located in Chicago, Illinc have prepared the comments for this issue. Both are currently memb of the Illinois Society's Local Practitioners Committee.

Emergency Assistance Plan of The Illinois Society of CPAs

The members of the Emergency Assistance Committee believe that information regarding the Emergency Assistance Plan should be conveyed to the members of the Illinois Society. The following series of questions and answers are designed to provide the most important information about this vital plan.

Question: What is the purpose of the Emergency Assistance Plan of the Illinois Society of Certified Public Accountants?

Answer: The purpose of the plan is to render ASSISTANCE to a member or to the estate of a member of the Illinois Society of Certified Public Accountants in the event of an EMERGENCY. The committee charged with the responsibility of administering the plan has therefore been designated as the EMERGENCY ASSISTANCE COMMITTEE.

Question: What constitutes an EMERGENCY?

Answer: The death or physical incapacity of a participant of the plan is, for the purposes of the plan, considered an emergency.

Question: Who may become a participant of the plan and how is it accomplished?

Answer: Any member of the Society may become a participant of the plan by requesting from the Society, and filing with the Society an enrollment form upon which the participant shall list not less than two (2) nor more than six (6) members who, in the opinion of the participant, could best serve the interests of the participant's clients in the event of the participant's death or physical incapacity.

Question: What is the nature of the ASSISTANCE which the committee can render to a participant?

Answer: Upon the death of a participant, one or more members of the committee shall undertake to transfer the participant's practice to the practitioners designated by the participant in his list and secure for the participant's widow or estate a designated monetary sum based on a formula established in the plan.

Question: Are any added fees or dues payable to the Society for this service?

Answer: No.

Question: Could the Emergency Assistance Plan be of any possible aid to a member if he already has an arrangement with another C.P.A. to take over in the event of the member's death or disability?

Answer: Since life is uncertain, filing an enrollment form which is to become effective only if the participant dies or becomes disabled would insure prompt action to protect the participant's estate and would furnish another string for his bow. The legal representative of the deceased participant may decline the Society's offer of assistance.

Question: Does the Emergency As-

sistance Plan have any interest for the large local firm or for the national firm?

Answer: Frankly, no—it was intended primarily for the individual practitioner and is tailored to meet his specific needs.

Question: Will a member of the Committee be disqualified from acquiring a practice under the plan if he has been listed by a participant?

Answer: If a member of the committee has been selected by a participant then that member will take no part in the committee activities in the administration of the participant's practice. The other members of the committee will then be charged with the administration.

Question: May a participant change the names listed on his original enrollment form?

Answer: Yes, the Emergency Assistance Plan is voluntary and, like a will, it can be changed or withdrawn at any time.

Question: What has been the nature of response to the Emergency Assistance Plan?

Answer: The response has been two-fold. Some C.P.A.s have sent in their enrollment forms and others have reported to the committee that, spurred by the ideas in the Emergency Assistance Plan, they have worked out individual plans with other C.P.A.s to become effective upon their death or disability.

Question: Who retains custody of the enrollment forms?

Answer: The committee does not have possession of, nor access to the enrollment forms. They are kept in the confidential files of the Executive Secretary. As a matter of fact, a participant may elect to send the enrollment form to the Society in a sealed envelope bearing the instruction "Open only upon my death".

Question: If a participant wh executed the enrollment form do not file it with the Society, but cor pletes the form and instructs his a torney, widow or other legal repr sentative to notify the committee its contents at the proper time wi the Emergency Assistance Committ render its services?

Answer: Yes, but it is believed th delay will be encountered in waiti for the proper authority to tal action, whereas if the papers are file in the Society office, less delay wi be involved in an effort to keep t participant's practice in existence

Question: What are the basic ben fits of the plan?

Answer: First, the widow will r ceive, subject to some limitation twenty-five percent (25%) of t fees earned by the successor accoun ant for a period of forty-eight (4 months following the participant death. Second, the participant will able to assure his client of an order and uninterrupted accounting servi following his death or disability.

Question: Will the Committee a sist the widow of a member who do not complete the proper forms?

Answer: It is believed that assistance of the Committee had be desired the member would have tak the necessary steps during his lif time. Nevertheless, if the widow do learn of the services of the Eme gency Assistance Committee, and s requests its assistance, the committ would help to the best of its abilit However, one of the basic elements the plan, that the names of the ind vidual accountants best qualified continue a member's practice, w not be present.

Question: What if disputes arise between the purchaser and the representatives of the participant?

Answer: The Committee shall act as an arbitrator of any disputes between the successor CPA and the representative when requested to do so by both parties.

It is urged that all practitioners, who recognize the need for this assistance, take immediate steps to complete the enrollment forms previously sent to them or request new forms from the society and submit them with the least possible delay.

STATEMENT ON AUDITING PROCEDURE NUMBER 30

The Committee on Auditing Procedure of the AICPA issued in late November *Statement on Auditing Procedure Number 30,* "Responsibilities and Functions of the Independent Auditor in the Examination of Financial Statements." The purpose of the bulletin is to clarify the Institute position in connection with these responsibilities. The bulletin is actually a restatement of a section of the *Codification of Statements on Auditing Procedure.*

While the actual phraseology of the complete bulletin should be studied carefully, the following summary indicates the highlights of the new statement by the Committee:

1. "The objective of the ordinary examination of financial statements by the independent auditor is the expression of an opinion on the fairness of their presentation."

2. "Management has the responsibility for the proper recording of transactions in books of account, for the safeguarding of assets, and for the substantial accuracy and adequacy of financial statements."

3. "The independent auditor's responsibility is confined to the expression of a professional opinion on the financial statements he has examined."

4. ". . . the ordinary examination incident to the expression of an opinion on financial statements is not primarily or specifically designed, and cannot be relied upon, to disclose defalcations and other similar irregularities, although their discovery may result.

5. "The responsibility of the independent auditor for failure to detect fraud (which responsibility differs as to clients and others) arises only when such failure clearly results from noncompliance with generally accepted auditing standards."

6. "The subsequent discovery that fraud existed during the period covered by the independent auditor's examination does not of itself indicate negligence on his part. He is not an insurer or guarantor and, if his examination was made with due professional skill and care, in accordance with generally accepted auditing standards, he has fulfilled all of his obligations implicit in his undertaking."

AS WE GO TO PRESS

ACCOUNTING RESEARCH

The accounting research division of the American Institute of Certified Public Accountants has added two items to its active research agenda —Accounting for the Costs of Pension Plans, and "Cash Flow" Statements and Analysis. These items are in addition to five studies previously announced and presently under active study.

Accounting for Costs of Pension Plans. Previous pronouncements on this subject were made by the committee on accounting procedure, the most recent being Accounting Research Bulletin No. 47, issued in 1956. The new research project will explore the subject more thoroughly than was possible in the past, and will include a review of the existing bulletins. The study may be expanded to include other post-employment or retirement compensation arrangements. This project will be under the specific direction of Mr. Alexander Russ, Research Supervisor, of the staff of the accounting research division.

"Cash-Flow" Statements and Analysis. For many years the literature of accounting has included the preparation of statements known as "statement of source and application of funds" or some other characterization, while more recently financial analysts and others have experimented with revised earnings figures to put them on a "cash flow" basis. This study will include a survey of practice in the use of such statements in the past and will explore the possibility of making adjustments and analyses such as have more recently been made, including a consideration of any dangers in misuse of such data. The research on this project will be focused upon the information provided for stockholders, investors, and others interested in the annual reports of corporations and other business enterprises. The project will be under the specific direction of Mr. Perry Mason, Associate Director of Accounting Research, of the staff of the accounting research division.

Anyone interested in submitting comments, suggestions, or other material for the use of the research staff, on these new projects and the ones previously announced as well, is invited and urged to do so. Such correspondence should be addressed to Mr. Maurice Moonitz, Director of Accounting Research, at the Institute offices in New York.

"THE AUDITORS HAVE ARRIVED"

"The Auditors Have Arrived," a two-part article appearing in **Fortune** in November and December, discloses considerable information of interest about the accounting profession. In this series Mr. Thomas A. Wise presents probably the most comprehesive discussion ever accorded the accounting profession in a widely-read publication. While many may find particular statements which could be phrased differently to present a better "image" of the profession, the articles are generally fair and well presented. All interested in the profession, including those students presently contemplating entering the profession, should find Mr. Wise's comments both interesting and informative.

SOCIETY MEMBERS APPOINTED

Several recent appointments to chairmanships of important American Institute of CPA committees involve members of the Illinois Society. **Donald Erickson,** partner in charge of the Chicago office of Arthur Andersen & Co., has been reappointed chairman of the committee on relations with the Civil Aeronautics Board. **Jack C. Ellis,** partner in the firm of Morgan, Clifton, Gunderson & Ellis, Peoria, has been reappointed chairman of the committee on savings and loan auditing. **Lawrence E. Rocca,** partner in the firm of Ernst & Ernst, Chicago, has been appointed chairman of the committee on local government accounting. **Richard S. Claire,** partner in the Chicago office of Arthur Andersen & Co., has been appointed chairman of the committee on meetings. This committee will have the primary responsibility for arrangements for the Institute 1961 annual meeting to be held in Chicago next October.

In addition, the following Society members have recently been elected to Council, governing body of the AICPA:

C. R. Miller, partner in the Chicago office of Arthur Young & Co.

Raymond A. Hoffman, partner in the Chicago office of Price Waterhouse & Co.

Richard S. Claire, partner in the Chicago office of Arthur Andersen & Co.

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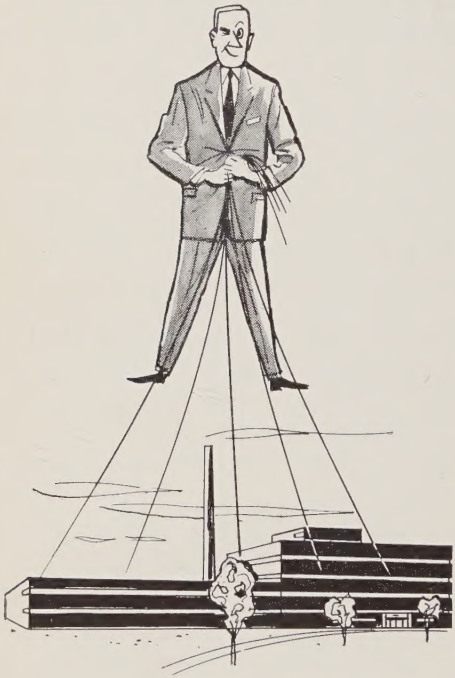

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